

Intelligent Investor Equity Income Portfolio

Monthly update

PERFORMANCE TO 31 MAY 2019	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS (P.A.)	3 YRS (P.A.)	S. I. (P.A.)
Intelligent Investor Equity Income	0.02%	1.87%	6.90%	1.15%	3.80%	6.26%	8.83%
S&P/ASX 200 Accumulation Index	1.71%	4.88%	15.32%	11.08%	10.35%	10.60%	8.86%
Excess to Benchmark	-1.69%	-3.01%	-8.42%	-9.94%	-6.55%	-4.34%	-0.03%

'If you played golf and you hit a hole in one on every hole, nobody would play golf, it's no fun. You've got to hit a few in the rough and then get out of the rough. That makes it interesting.' — **Warren Buffett**.

'The market is quickly becoming less about finding good businesses and more about managing the day's headlines.' Sports talk radio host Mike Francesa.

'The conventional view serves to protect us from the painful job of thinking.' John Kenneth Galbraith.

Premature election relief?

It wasn't just the sound of corks popping that you could hear after Scott Morrison was voted back in as Prime Minister. With changes to franking credits, negative gearing and a host of other taxes proposed by Labor largely nixed, share prices of companies that had dodged a bullet popped as the market celebrated a return to business as normal. But what is normal?

Although Australian property prices appear to be stabilising in the major markets of Sydney and Melbourne, high debt levels will continue to weigh on economic activity. Earnings estimates are mostly falling, so we're hunting sensibly priced businesses that can add value without relying on strong credit growth.

As you'll read below, our preference for entrepreneurial, founder-led businesses shows our CEOs are energetically planting the seeds of future success even though it often doesn't show up instantly as higher

earnings. Failure to sacrifice short-term earnings growth to invest in the long-term health of your business in today's competitive markets is a sure path to ruin.

The surprise Coalition victory didn't have a material impact on the portfolio's returns. In the spirit of Jesse Livermore, who said 'It never was my thinking that made the big money for me. It always was my sitting.', there were no transactions this month. But there were some important company announcements.

Portfolio

Reliance Worldwide Corporation's share price initially dropped over 20% after announcing a fairly small and well-flagged profit warning. The announcement was very messy, reflecting numerous changes in the business. But it was management's suggestion that its innovative products were already mature despite only accounting for ~10% of total market sales that likely shocked investors.

At least the recent acquisition of John Guest in the UK is on track. Management currently has a lot of balls in the air, and we'd very much like to see the company's free cashflow improve.

Like Buffett's quote above, **Link Administration** is squarely in the rough. It blamed a profit downgrade on Brexit delaying IPOs where Link was the administrator. Indeed, UK financial activity has recently collapsed.

Higher costs have also lingered to deal with regulatory changes affecting Australia's superannuation sector.

Our long-term case for owning Link includes further acquisitions in an industry that requires scale (i.e. large size) to relentlessly reduce costs. Link also owns a 44% share of PEXA (a fledgling monopolistic digital property lodgement and settlement business in Australia) that should eventually earn material profits when it reaches scale.

“BREXIT IS ALSO AFFECTING OUR HOLDINGS IN CLYDESDALE BANK AND RELIANCE WORLDWIDE, BUT EVENTUALLY WE EXPECT TO LOOK BACK AT THIS TUMULTUOUS TIME AS A WONDERFUL BUYING OPPORTUNITY.”

The company's investor day is 18 June and we'd like to see its major contract with REST signed, sealed and delivered. Negotiations have been 'advanced' for well over a year. Link also needs to renew agreements with all its major Australian superannuation clients over the next couple of years.

Brexit is also affecting our holdings in Clydesdale Bank and Reliance Worldwide, but eventually we expect to look back at this tumultuous time as a wonderful buying opportunity.

The king surrenders his crown

James Packer announced that he's ceding control of **Crown Resorts** by selling a 20% stake in the company at \$13 per share to his friend and ex-business partner Lawrence Ho of Chinese gaming company Melco

Resorts and Entertainment. That's nearly half Packer's shareholding at a price well below the prior offer of \$14.75 per share from US gaming company Wynn that's now likely permanently off the table.

Crown remains a small holding due to valuation, and we expect to find better ideas like **360 Capital** over time. 360 Capital's share price hasn't budged despite announcing a 50/50 joint venture named 360 Capital Global Digital Infrastructure Partners with telecommunications entrepreneur David Yuile.

Initially a US\$250m fund will target data centres, dark fibre, and cell towers and sites both in Australia and abroad. We're delighted that 360 Capital founder Tony Pitt has partnered with Yuile and bemused that 360's share price reflects no value for recently proposed fund raisings or Pitt's track record of success.

Summary

While the market is currently infatuated with a small group of technology companies and large dividend payers, we're finding value in high quality businesses that have been battle tested through many economic environments and that trade at safer valuations.

We also continue to invest in undiscovered emerging leaders. As **Audinate's** success in our Growth portfolios shows (and what we hope to repeat with stocks like 360 Capital), the returns for uncovering tomorrow's heroes and holding patiently until the market catches on are huge. Backing founder-led businesses that can compound your money at high rates for a very long time is what continually excites us about helping you grow your wealth in addition to owning a core group of reliable dividend payers.

Portfolio allocation

ASSET ALLOCATION	
Sector	Weighting
Financials	24.17%
Consumer Discretionary	20.11%
Industrials	15.84%
Consumer Staple	10.34%
Real Estate	8.89%
Cash	8.39%
Other	4.13%
Information Technology	2.95%
Communication Services	2.94%
Health Care	2.25%

TOP 5 HOLDINGS	
Security	Weighting
Commonwealth Bank (CBA)	8.97%
Australian Cash	8.70%
Westpac Bank Corporation (WBC)	6.48%
Seek Limited (SEK)	5.42%
Lovisa Holdings Ltd (LOV)	5.08%

Performance numbers exclude franking, after investment and admin fees; excludes brokerage. All yield figures include franking. All performance figures, graphs and diagrams are as at 31 May 2019. Performance figures are based on the portfolio's previous investment structure, a Separately Managed Account (SMA). This portfolio is now offered as a Professionally Managed Account (PMA), as of 1 November 2018. The underlying securities remain the same between the SMA and PMA structures. The inception date refers to the SMA. Please see the Investment Menu for full PMA fee details.



Skin In The Game podcast

Join portfolio managers Nathan Bell and Alex Hughes weekly as they discuss stocks, economics, their respective portfolios and much more.



InvestSMART Group Limited (INV)

was founded in 1999 and is a leading Australian digital wealth advisor which has over 32,000 clients and over \$1.4B in assets under advice. InvestSMART's goal is to provide quality advice and low cost investment products, free from the jargon and complexities so commonly found in the finance industry, to help you meet your financial aspirations.

The Portfolio

The Intelligent Investor Equity Income Portfolio is a concentrated portfolio of 10 - 35 Australian-listed stocks, focused on generating income while still achieving capital growth. The Portfolio focuses on large, mature businesses with entrenched competitive advantages, and dominant smaller companies we believe will produce strong cash flows to support dividends in the future.

Investment objective

The Portfolio's investment objective is to produce a sustainable income yield above that of the S&P/ASX 200 Accumulation Index.

Why the Intelligent Investor Equity Income Portfolio?

Australia has one of the world's most stable and highest returning share markets and is often considered a safe-haven by investors. As contrarian value investors, producing safe and attractive returns in the stock market means sticking to a disciplined and repeatable process. We do this by patiently waiting for overreactions in share prices, so we can buy at a large discount to our estimate of intrinsic value.

Who manages the investment?

Nathan Bell, has over 20 years of experience in portfolio management and research and is supported by our Investment Committee, chaired by Paul Clitheroe. Before returning to InvestSMART in 2018 as Portfolio Manager, he was the Research Director at our sister company, Intelligent Investor for nine years which included over four years as Portfolio Manager and being a member of the Compliance Committee. Nathan has a Bachelor of Economics and subsequently completed a Graduate Diploma of Applied Investment and Management. Nathan is a CFA Charterholder.

Key Details

INVESTMENT CATEGORY

A portfolio of individually-selected Australian Equities

INVESTMENT STYLE

Active Stock Selection, Value Investing Approach

BENCHMARK

S&P/ASX 200 Accumulation Index

INCEPTION DATE

1 July 2015

SUGGESTED INVESTMENT TIMEFRAME

5+ years

NUMBER OF SECURITIES / STOCKS

10 - 35 stocks

INVESTMENT FEE

0.60% - 0.97% p.a.

PERFORMANCE FEE

N/A

MINIMUM INITIAL INVESTMENT

\$25,000

STRUCTURE

Professionally Managed Account (PMA)

SUITABILITY

Suitable for investors who are seeking domestic equity exposure with a growing stream of dividends to offset inflation

PORTFOLIO MANAGER

Nathan Bell, CFA

Important information

While every care has been taken in preparation of this document, InvestSMART Funds Management Limited (ABN 62 067 751 759, AFSL 246441) ("InvestSMART") makes no representations or warranties as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.

This document has been prepared by InvestSMART. Financial commentary contained within this report is provided by InvestSMART. The information contained in this document is not intended to be a definitive statement on the subject matter nor an endorsement that this model portfolio is appropriate for you and should not be relied upon in making a decision to invest in this product.

The information in this report is general information only and does not take into account your individual objectives, financial situation, needs or circumstances. No representations or warranties express or implied, are made as to the accuracy or completeness of the information, opinions and conclusions contained in this report. In preparing this report, InvestSMART has relied upon and assumed, without independent verification, the accuracy and completeness of all information available to us. To the maximum extent permitted by law, neither InvestSMART, their directors, employees or agents accept any liability for any loss arising in relation to this report.

The suitability of the investment product to your needs depends on your individual circumstances and objectives and should be discussed with your Adviser. Potential investors must read the Product Disclosure Statement (PDS) and Investment Menu (IM), and FSG along with any accompanying materials.

Investment in securities and other financial products involves risk. An investment in a financial product may have the potential for capital growth and income, but may also carry the risk that the total return on the investment may be less than the amount contributed directly by the investor.

Past performance of financial products is not a reliable indicator of future performance. InvestSMART does not assure nor guarantee the performance of any financial products offered.

Information, opinions, historical performance, calculations or assessments of performance of financial products or markets rely on assumptions about tax, reinvestment, market performance, liquidity and other factors that will be important and may fluctuate over time.

InvestSMART, its associates and their respective directors and other staff each declare that they may, from time to time, hold interests in Securities that are contained in this investment product. As Responsible Entity, InvestSMART is the issuer of the product through the Managed Investment Scheme (ARSN: 620 030 382).

InvestSMART Funds Management Limited
PO Box 744
Queen Victoria Building
NSW 1230 Australia

Phone: 1300 880 160
Email: invest@investsmart.com.au

www.investsmart.com.au